Financial Industry Regulatory Authority

November 1, 2007

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: File No. SR-NASD-2007-041 – Proposed Rule Change to Amend the Minimum Price-Improvement Standards Set Forth in NASD Interpretive Material 2110-2; Response to Comments

Dear Ms. Morris:

On June 27, 2007, the National Association of Securities Dealers, Inc. or "NASD" (n/k/a Financial Industry Regulatory Authority, Inc. or "FINRA") filed with the Securities and Exchange Commission ("Commission") SR-NASD-2007-041, proposing amendments to the minimum price-improvement standards set forth in NASD Interpretive Material (IM) 2110-2, Trading Ahead of Customer Limit Order.

On August 28, 2007, the Commission published for comment the proposed rule change in the Federal Register.[1] The Commission received one comment letter in response to the Federal Register publication.[2] The commenter generally supports the proposal, but raised an issue relating to the application of the proposed minimum price-improvement standards that is summarized and responded to below.

Summary of Comments and Responses

The commenter generally supports FINRA's proposal to amend the minimum price-improvement standards, indicating that tiered price-improvement standards offer a sensible solution. The commenter, however, raises an inconsistency in the application of the proposed minimum price-improvement standards in low-priced securities when the triggering proprietary trade and the customer limit order fall into more than one of the proposed tiers. For example, if the best inside market for an NMS security is $.996 to

1 See Securities Exchange Act Release No. 56297 (August 21, 2007), 72 FR 49337 (August 28 2007) (notice of filing of SR-NASD-2007-041).

2 The Commission received one comment letter from Jess Haberman, Compliance Director, Fidessa Corp. ("Fidessa Letter").

1735 K Street, NW
Washington, DC
20006-1506

t 202 728 8000
www.finra.org

$1.00 and the firm sells for its own account at $.995,[3] then, pursuant to the proposed changes to IM-2110-2, a customer limit order to sell priced below $.997 would be protected and a customer limit order to sell priced from $1.00 up to, but not including, $1.005 also would be protected.[4] However, a customer limit order to sell priced from $.997 up to, but not including, $1.00 would not be protected. The commenter indicates that the proposed tiered requirements therefore result in a more aggressively priced sell order ($.997) not being protected under IM-2110-2, while a higher priced sell order ($1.00) is protected under IM-2110-2. To address this anomaly, the commenter recommends that the staff base the minimum price-improvement standards on the trade price, rather than the order price.

FINRA appreciates the concerns raised by the commenter with regard to potential issues in application under the proposal. However, FINRA continues to believe that the proposed rule change provides a reasonable framework for imposing minimum price improvement standards for low-priced securities. While FINRA agrees that the commenter's proposed alternative approach would address some of the potential anomalies in the application of the proposed rule, FINRA is concerned that this revised approach could have unintended consequences in its application and would require significant reprogramming by the firms to implement. As such, FINRA is not proposing any changes at this time. If approved, however, FINRA intends to continue to monitor the application of the minimum price-improvement standards in low-priced securities and invites further comment and specific data from firms surrounding the practical impact of the minimum price improvement standards.

In addition, FINRA understands that firms may choose to provide voluntarily protection to those more aggressively priced customer limit orders that fall within the gaps. FINRA believes it would not be an unreasonable policy or procedure and would be consistent with the principles underlying IM-2110-2 and the duty of best execution to fill those more aggressively priced customer sell orders ahead of those other orders that are less aggressively priced, but directly triggered by the rule. Firms that choose to implement such a methodology must have written policies and procedures to that effect and must apply such methodology consistently.[5]

---

3 In the Fidessa Letter, the commenter provides an example where the firm sold for its own account at $.996. Because a trade at $.996 would be at the current inside spread, we have used $.995 as the price of the triggering trade to broaden the number of customer limit orders triggered, which we believe better demonstrates the full extent of the potential anomaly.

4 The reference to orders above $1.00 in subpenny increments is for example purposes only. FINRA staff notes that Rule 612 of Regulation NMS prohibits market participants from displaying, ranking, or accepting quotations, orders, or indications of interest in any NMS stock priced in an increment smaller than $0.01 if the quotation, order, or indication of interest is priced equal to or greater than $1.00 per share. See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR37496 (June 29, 2005).

5 See Special NASD Notice to Members 95-43, at 308 (June 5, 1995).

The commenter also requested clarification on the required price-improvement where the limit order is priced outside the inside market for the security. As proposed, where the limit order is priced outside the inside market for the security, the minimum amount of price improvement required must either meet the same tiered minimum price improvement standards or the member must trade at a price at or inside the best inside market for the security. The commenter asks for clarification regarding how a firm determines which method to use. FINRA is clarifying that firms need only meet one of the minimum price improvement options provided for limit orders priced outside the inside market and may do so on a trade-by-trade basis.

* * * * *

FINRA believes that the foregoing responds to the material issues raised by the commenter to this rule filing. If you have any questions, please contact me at (202) 728-8156; email: andrea.orr@finra.org. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Andrea D. Orr
Assistant General Counsel

cc: Ronesha Butler (Securities and Exchange Commission)